
Answers

Section B

1 Ethical threats and managing these risks

(i) Ethical threat

The finance director is the sister-in-law of the audit engagement partner and hence there is a family relationship.

There is a familiarity and self-interest threat as the audit partner and the finance director both hold senior positions and therefore are in a position to influence the outcome of the audit. There is a concern that they may place their family relationship above the needs of the users of the financial statements.

Golden Finance Co's (Golden) finance director has asked if a member of the audit team can be seconded to fill the role of financial controller.

A self-review risk arises if the team member prepares records and schedules which support the financial statements and is then part of the audit team responsible for auditing these.

Two members of the audit team have significant loans owing to the company. Golden is a banking institution and hence the provision of a loan is within the normal course of business.

However, if either of the loans has any preferential terms, such as rates or repayment periods, then this would represent a self-interest threat.

Golden has requested that Pink's taxation department represents them in negotiations to resolve some outstanding issues with the taxation authorities.

There is a potential advocacy threat where the firm may promote an opinion on behalf of Golden, such that the independence of the firm is compromised.

In addition, the outcome of these issues may have a material impact on the financial statements, resulting in a self-review threat.

The taxation fees being quoted to Golden are substantial.

There is a potential self-interest threat as the total fees could represent a significant proportion of Pink's income and the firm could become overly reliant on Golden.

The finance director has invited the whole team to attend an evening out watching the national football team play a match followed by a luxury meal.

This represents a self-interest and familiarity threat as the acceptance of goods and services, unless insignificant in value, is not permitted.

(ii) Managing these risks

Although the family relationship is only established by marriage, as it is a sister-in-law, it would be advisable for the audit engagement partner to be removed and an alternative partner appointed.

Pink Partners & Co (Pink) should clarify exactly which areas the seconded team member would assist Golden on. Though it is likely that as the financial controller, the team member will be directly involved in dealing with items related to the financial statements.

As such, the request from the finance director should be politely declined, or the team member should be removed from the audit of Golden.

The terms of the loans should be reviewed to ascertain whether they are in any way preferential. If not, no further action is required.

However, if the terms are preferential then either the terms should be amended or these two members should be removed from the audit team.

Due to the likelihood of these issues having a material impact on the financial statements and the advocacy threat, it is advisable that the firm politely declines this request.

Pink should assess whether audit, non-audit and total taxation fees would represent a significant proportion of recurring fee income.

If the recurring fees are likely to be significant, additional consideration should be given as to whether the taxation and/or non-audit assignments should be undertaken by the firm.

As it is unlikely the football tickets and luxury meal for the whole team has an insignificant value, then this offer should be politely declined.

2 (a) Engagement letters

Engagement letters for recurring/existing clients should be revised if any of the following factors are present:

- Any indication that the entity misunderstands the objective and scope of the audit, as this misunderstanding would need to be clarified.
- Any revised or special terms of the audit engagement, as these would require inclusion in the engagement letter.
- A recent change of senior management or significant change in ownership. The letter is signed by a director on behalf of those charged with governance; if there have been significant changes in management they need to be made aware of what the audit engagement letter includes.

- A significant change in nature or size of the entity’s business. The approach taken by the auditor may need to change to reflect the change in the entity and this should be clarified in the engagement letter.
- A change in legal or regulatory requirements. The engagement letter is a contract; hence if legal or regulatory changes occur, then the contract could be out of date.
- A change in the financial reporting framework adopted in the preparation of the financial statements. The engagement letter clarifies the role of auditors and those charged with governance, it identifies the reporting framework of the financial statements and if this changes, then the letter requires updating.
- A change in other reporting requirements. Other reporting requirements may be stipulated in the engagement letter; hence if these change, the letter should be updated.

(b) Matters to be included in an audit engagement letter

- The objective and scope of the audit;
- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of the financial reporting framework for the preparation of the financial statements;
- Expected form and content of any reports to be issued;
- Elaboration of the scope of the audit with reference to legislation;
- The form of any other communication of results of the audit engagement;
- The fact that some material misstatements may not be detected;
- Arrangements regarding the planning and performance of the audit, including the composition of the audit team;
- The expectation that management will provide written representations;
- The basis on which fees are computed and any billing arrangements;
- A request for management to acknowledge receipt of the audit engagement letter and to agree to the terms of the engagement;
- Arrangements concerning the involvement of internal auditors and other staff of the entity;
- Any obligations to provide audit working papers to other parties;
- Any restriction on the auditor’s liability;
- Arrangements to make available draft financial statements and any other information;
- Arrangements to inform the auditor of facts which might affect the financial statements, of which management may become aware during the period from the date of the auditor’s report to the date the financial statements are issued.

(c) Understanding an entity

Prior year financial statements: Provides information in relation to the size of Milky Way Technologies Co (Milky Way) as well as the key accounting policies, disclosure notes and whether the audit opinion was modified or not.

Discussions with the previous auditors/access to their files: Provides information on key issues identified during the prior year audit as well as the audit approach adopted.

Prior year report to management: If this can be obtained from the previous auditors or from management, it can provide information on the internal control deficiencies noted last year. If these have not been rectified by management, then they could arise in the current year audit as well and may impact the audit approach.

Milky Way’s accounting systems notes/procedural manuals: Provides information on how each of the key accounting systems operates and this will be used to identify areas of potential control risk and help determine the audit approach.

Discussions with management: Provides information in relation to the business, any important issues which have arisen or changes to accounting policies from the prior year.

Review of board minutes: Provides an overview of key issues which have arisen during the year and how those charged with governance have addressed them.

Current year budgets and management accounts: Provides relevant financial information for the year to date. It will help the auditor during the planning stage for preliminary analytical review and risk identification.

Milky Way’s website: Recent press releases from the company may provide background on the business during the year as this will help in identifying the key audit risks.

Financial statements of competitors: This will provide information about Milky Way’s competitors, in relation to their financial results and their accounting policies. This will be important in assessing Milky Way’s performance in the year and also when undertaking the going concern review.

3 (a) Going concern indicators

During the year a number of Mercury's significant customers have experienced a fall in sales, hence they have purchased fewer items from Mercury. There is a risk that if Mercury's customers continue to reduce the level of their purchases, this will reduce Mercury's sales and future cash flows. In addition, Mercury may need to reduce their prices in order to boost sales volumes, which will impact profits and cash flows.

Mercury has paid some of its suppliers later than usual and hence some of them have withdrawn credit terms meaning the company must pay cash on delivery. This puts additional pressure on the company's cash flow. This is because the company has to pay for goods in advance but it may not receive cash from its receivables until some time later.

One of Mercury's main suppliers is threatening legal action to recover the sums owing. If this occurs, then Mercury will have legal costs in addition to the amounts already owed and this will further increase the pressure on cash flows. In addition, other suppliers may hear about the legal action and, as a result, stop supplying goods to the company.

The company's current ratio has fallen below 1 to 0.9 for the first time. The current ratio is showing that the current assets are not sufficient to pay the current liabilities. This is another indication of the worsening liquidity position of the company.

Mercury has produced a cash flow forecast to 30 June 2016 and this shows net cash outflows until May 2016. If the company continues to have cash outflows, then it will put further pressure on the company's cash flows and there is the risk that it will start to run out of available cash.

Mercury has a significant loan which is due for repayment in full by 30 September 2016. The company only has nine months to raise the \$2.3 million and with falling levels of sales and negative cash flows forecast until May 2016, it is difficult to see how they will be able to raise alternative finance to pay this amount.

Mercury is facing a possible change in legislation which will result in one of its top product lines becoming obsolete. Whilst this is only a possible change in the law, if it does come into force then the inventory for this product may have to be scrapped, resulting in a large write off and possible reduced sales, profit and cash flows.

(b) Going concern procedures

- Discuss with management the basis for their going concern review and request that Mercury's management extend their cash flow forecast by three months to 30 September 2016.
- Review this extended cash flow forecast and review the cash in and outflows. Assess the assumptions for reasonableness and discuss the findings with management to understand if the company will have sufficient cash to meet its liabilities as they fall due.
- Perform a sensitivity analysis on the cash flows to understand the margin of safety the company has in terms of its net cash in/outflow.
- Discuss with the finance director whether the level of sales from its existing customers has increased or if any new customers have been obtained.
- Review the company's post year-end sales and order book to assess if the levels of trade are likely to increase and if the revenue figures in the cash flow forecast are reasonable.
- Discuss with the directors whether they have contacted any banks for finance to assess whether they have any other means of repaying the loan of \$2.3m due in September 2016.
- Review post year-end correspondence with suppliers to identify if any others have threatened legal action or refused to supply goods.
- Evaluate management's plans for future actions, including their contingency plans in relation to ongoing financing and plans for generating revenue, and consider the feasibility of these plans.
- Enquire of the lawyers of Mercury as to the existence of any additional litigation and request their assessment of the likely amounts payable to the supplier.
- Enquire of the lawyers as to their view with regards to the proposed change in legislation, which may render a key product line obsolete. In particular, their view of the likelihood of it actually becoming law within the period to 30 September 2016.
- Perform audit tests in relation to subsequent events to identify any items which might indicate or mitigate the risk of going concern not being appropriate.
- Review the post year-end board minutes to identify any other issues which might indicate further financial difficulties for the company.
- Review post year-end management accounts to assess if in line with cash flow forecast.
- Obtain a written representation confirming the directors' view that Mercury is a going concern.

4 Audit risk and auditor's responses

Audit risk

The directors have reviewed the asset lives and depreciation rates of plant and machinery, resulting in the depreciation charge reducing. Under IAS 16 *Property, Plant and Equipment*, asset lives should be reviewed annually, and if the asset lives have increased as a result of this review such that the depreciation decreases, then this change may be reasonable.

However, there is a risk that this reduction has occurred in order to achieve profit targets, due to the introduction of the bonus system. If this is the case, then plant and machinery is overvalued and profit overstated.

Due to staff availability, the company is planning to undertake a full year-end inventory count days before the year end and then adjust for movements to the year end.

If the adjustments are not completed accurately, then the year-end inventory could be under or overstated.

In October, a fire damaged inventory such that it has been written down from \$0.9m to \$0.2m which is its scrap value. This write down should have been charged to profit or loss.

If the goods remain unsold after the year end, there is the risk that the scrap value is overstated and inventory overvalued.

An insurance claim for \$0.7m has been submitted and the proceeds included within profit or loss.

However, the company has not received a reply from the insurance company and this would therefore represent a possible contingent asset. To comply with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, this should not be recognised until the receipt is virtually certain. With no response to date, the inclusion of this sum overstates profit and receivables.

The bank reconciliations for October and November both contain unreconciled amounts, and the finance director believes the overall differences to be immaterial.

Errors in bank reconciliations could actually represent large errors which net off to a small amount. If the differences are not fully reconciled, it could result in bank balances being under or overstated.

In addition, unreconciled amounts in the bank could have arisen due to fraud.

A directors' bonus scheme was introduced which is based on achieving a target profit before tax. There is a risk the directors might feel under pressure to manipulate the results through the judgements taken or through the use of provisions.

The finance director has requested that the audit commence earlier than normal as he wishes to report results earlier. A reduction in the audit timetable will increase detection risk and place additional pressure on the team in obtaining sufficient and appropriate evidence.

In addition, the finance team will have less time to prepare the financial information leading to an increased risk of errors arising in the financial statements.

Auditor's response

Discuss with the directors the rationale for any extensions of asset lives and reduction of depreciation rates.

The revised useful life of a sample of assets should be compared to how often these assets are replaced, as this provides evidence of the useful life of assets.

During the final audit the year-end inventory adjustments schedule should be reviewed in detail and supporting documentation obtained for all adjusting items.

The audit team should increase the extent of inventory cut-off testing at the year end.

Discuss with management the basis of the \$0.2m scrap value attributed.

Review whether any of the goods were sold pre or post year end and at what value; this should assess whether the attributed scrap value is reasonable. If none have been sold, discuss with management the possibility of further write downs.

Discuss with management whether any response has been received from the insurance company and review the related correspondence. If virtually certain, the treatment adopted is correct.

If not, management should be requested to remove it from profit and receivables. If the receipt is probable, the auditor should request management include a contingent asset disclosure note.

Discuss this issue with the finance director and request that the December reconciliation is fully reconciled. The reconciling items should be tested in detail and agreed to supporting documentation.

Throughout the audit, the team should be alert to the risk of fraud and maintain professional scepticism.

Throughout the audit, the team will need to be alert to this risk and maintain professional scepticism.

Detailed review and testing on judgemental decisions, including treatment of provisions, and compare treatment against prior years. Any journal adjustments affecting profit should be tested in detail.

In addition, a written representation should be obtained from management confirming the basis of any significant judgements.

The timetable should be confirmed with the finance director. If it is to be reduced, then consideration should be given to performing an interim audit in late December or early January; this would then reduce the pressure on the final audit.

The team needs to maintain professional scepticism and be alert to the increased risk of errors occurring.

5 (a) Bronze Industries Co (Bronze) payroll system internal control strengths

Strengths in Bronze's payroll system are as follows:

- Factory staff are each issued a sequentially numbered clock card which details their employee number and name. This should ensure that employees are only paid for hours they have worked and that the payroll records record completely all employees, as any gaps in the sequence would be identified.
- The payroll system automatically calculates gross and net pay along with any statutory deductions. This should reduce the risk of employees' wages and statutory deductions being incorrect as there is a reduced risk of errors occurring.
- A sample of the calculations made by the automated system is checked by the payroll supervisor to ensure the system is operating effectively; this tests the automated controls within the system.
- Bronze has a human resources department which is responsible for setting up new permanent employees and leavers. Having a segregation of roles between human resources and payroll departments reduces the risk of fictitious employees being set up and also being paid.
- The discretionary bonus is communicated in writing to the payroll department. As this is in writing rather than verbal, this reduces the risk of the bonus being recorded at an incorrect amount in the payroll records.
- For employees paid by bank transfer, the list of the payments is reviewed in detail and agreed to the payroll records prior to authorising the bank payment. This reduces the risk of fraudulent payments being made through the creation of fictitious employees and other employees being omitted from the payment run.

(b) Bronze payroll system deficiencies and controls

Deficiencies	Controls
Employees swipe their cards at the beginning and end of the eight-hour shift; this process is not supervised. This could result in a number of employees being swiped in as present when they are not. This will result in a substantially increased payroll cost for Bronze.	The clocking in and out process should be supervised by a responsible official to prevent one individual clocking in multiple employees. A supervisor should undertake a random check of employees by reviewing who has logged in with a swipe card and confirming visually that the employee is present.
Employees are entitled to a 30-minute paid break and do not need to clock out to access the dining area. Employees could be taking excessive breaks resulting in a decrease in productivity and increased payroll costs.	Employees should be allocated set break times and there should be a supervisor present to ensure that employees only take the breaks they are entitled to.
Although there is a human resources department, appointments of temporary staff are made by factory production supervisors.	All appointment of staff, whether temporary or permanent, should only be made by the human resources department.
The supervisor could appoint unsuitable employees and may not carry out all the required procedures for new joiners. This could result in these temporary employees not receiving the correct pay and relevant statutory deductions.	
Overtime reports which detail the amount of overtime worked are sent out quarterly by the payroll department to production supervisors for review. These reports are reviewed after the payments have been made which could result in unauthorised overtime or amounts being paid incorrectly and Bronze's payroll cost increasing.	All overtime should be authorised by a responsible official prior to the payment being processed by the payroll department. This authorisation should be evidenced in writing.
Production supervisors determine the amount of the discretionary bonus to be paid to employees. Production supervisors are not senior enough to determine this as they could pay extra bonuses to friends or family members.	The bonus should be determined by a more senior individual, such as the production director, and this should be communicated in writing to the payroll department.
The bonus is input by a clerk into the payroll system. There is no indication that this input process is reviewed. This could result in input errors or the clerk could fraudulently change the amounts leading to incorrect bonus payments.	Once the clerk has input the bonus amounts, all entries should be double checked against the written confirmation from the production director by another member of the team to identify any amounts entered incorrectly.
The payroll manager reviews the bank transfer listing prior to authorising the payments and also amends the payroll records for any changes required.	The payroll manager should not be able to process changes to the payroll system as well as authorise payments. The authorisation of the bank transfer listing should be undertaken by an individual outside the payroll department, such as the finance director.
There is a lack of segregation of duties as it is the payroll team which processes the amounts and the payroll manager who authorises payments. The manager could fraudulently increase the amounts to be paid to certain employees, process this payment as well as amend the records.	

Deficiencies

A payroll clerk distributes cash pay packets to employees without requesting proof of identity. Even if most employees are known to the clerk, there is a risk that without identity checks wages could be paid to incorrect employees.

Controls

The payroll clerks should be informed that all cash wages can only be paid upon sight of the employee's clock card and photographic identification as this confirms proof of identity.

(c) Substantive analytical procedures to confirm payroll expense

- Compare the total payroll expense to the prior year and investigate any significant differences.
- Review monthly payroll charges, compare this to the prior year and budgets and discuss with management any significant variances.
- Compare overtime pay as a percentage of factory normal hours pay to investigate whether it is at a similar level to the prior year and within an acceptable range. Investigate any significant differences.
- Perform a proof in total of total wages and salaries, incorporating joiners and leavers and any pay increase. Compare this to the actual wages and salaries in the financial statements and investigate any significant differences.

6 (a) Reliability of audit evidence

The following factors or generalisations can be made when assessing the reliability of audit evidence:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence which is generated internally is increased when the related controls imposed by the entity, including those over its preparation and maintenance, are effective.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence in documentary form, whether paper, electronic or other medium, is more reliable than evidence obtained orally.
- Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, the reliability of which may depend on the controls over their preparation and maintenance.

(b) (i) Inventory count procedures

Before the count

- Review the prior year audit files to identify whether there were any particular warehouses where significant inventory issues arose last year.
- Discuss with management whether any of the warehouses this year are new, or have experienced significant control issues.
- Decide which of the 12 warehouses the audit team members will attend, basing this on materiality and risk of each site.
- Obtain a copy of the proposed inventory count instructions, review them to identify any control deficiencies and if any are noted, discuss them with management prior to the counts.

During the count

- Observe the counting teams of Andromeda to confirm whether the inventory count instructions are being followed correctly.
- Select a sample of inventory and perform test counts from inventory sheets to warehouse aisle and from warehouse aisle to inventory sheets.
- Confirm the procedures for identifying and segregating damaged goods are operating correctly, and assess inventory for evidence of any damaged or slow moving items.
- Observe the procedures for movements of inventory during the count, to confirm that all movements have ceased.
- Obtain a photocopy of the completed sequentially numbered inventory sheets for follow up testing on the final audit.
- Identify and make a note of the last goods received notes and goods despatched notes for 31 December in order to perform cut-off procedures.
- Discuss with the internal audit supervisor how any raw materials quantities have been estimated. Where possible, reperform the procedures adopted by the supervisor.

(ii) Research and development

- Obtain and cast a schedule of intangible assets, detailing opening balances, amount capitalised in the current year, amortisation and closing balances.

- Agree the opening balances to the prior year financial statements.
- Agree the closing balances to the general ledger, trial balance and draft financial statements.
- Recalculate the amortisation charge for a sample of intangible assets which have commenced production and confirm it is line with the amortisation policy of straight line over five years.
- For the five new projects, discuss with management the details of each project along with the stage of development and whether it has been capitalised or expensed.
- For those expensed as research, agree the costs incurred to invoices and supporting documentation and to inclusion in profit or loss.
- For those capitalised as development, agree costs incurred to invoices and confirm technically feasible by discussion with development managers or review of feasibility reports.
- Review market research reports to confirm Andromeda has the ability to sell the product once complete and probable future economic benefits will arise.
- Review the disclosures for intangible assets in the draft financial statements are in accordance with IAS 38 *Intangible Assets*.

(c) Audit reports

One of the projects Andromeda has developed in the year does not meet the recognition criteria under IAS 38 *Intangible Assets* for capitalisation but has been included within intangible assets. This is contrary to IAS 38, as if the criteria are not met, then this project is research expenditure and should be expensed to profit or loss rather than capitalised.

The error is material as it represents 11.8% of profit before tax (0.98m/8.3m) and hence management should adjust the financial statements by removing this project from intangible assets and charging it to profit or loss instead. The finance director's argument that the balance is immaterial is not correct.

If management refuses to amend this error, then the audit report will need to be modified. As management has not complied with IAS 38 and the error is material but not pervasive, then a qualified opinion would be necessary.

A basis for qualified opinion paragraph would be needed and would explain the material misstatement in relation to the incorrect treatment of research and development and the effect on the financial statements. The opinion paragraph would be qualified 'except for'.

Section B

This marking scheme is given as a guide in the context of the suggested answers. Scope is given to markers to award marks where alternative relevant points are made.

1 Up to 1 mark per well explained threat, being ½ mark for identify and ½ mark for explain, and up to 1 mark for method of managing risk, overall maximum of 5 marks each for risks and managing of risks.

- Self-interest/familiarity threat – finance director related to audit partner
- Self-review threat – team member seconded to client
- Self-interest threat – provision of loans
- Advocacy/self-review threat – resolving issues with taxation authorities
- Self-interest threat – substantial taxation fees
- Self-interest/familiarity threat – invitation for team to football match and meal

10

2 (a) 1 mark for each factor identified and adequately explained.

- Entity misunderstands the objective and scope of the audit
- Revised or special terms of the audit
- Recent change of senior management/change in ownership
- Change in nature or size of the entity’s business
- Change in legal or regulatory requirements
- Change in the financial reporting framework
- Change in other reporting requirements

2

(b) ½ mark per valid point.

- Objective/scope
- Responsibilities of auditor
- Responsibilities of management
- Identification of framework for financial statements
- Form/content reports
- Elaboration of scope
- Form of communications
- Some misstatements may be missed
- Arrangement for audit
- Written representations required
- Basis of fees/billing
- Management acknowledge letter
- Internal auditor arrangements
- Obligations to provide working papers to others
- Restriction on auditor’s liability
- Arrangements to make draft financial statements available
- Arrangements to inform auditors of subsequent events

3

(c) ½ mark for source of documentation and ½ mark for describing relevance of info, maximum of 2½ marks for sources and 2½ marks for relevance.

- Prior year financial statements
- Previous auditor/access to their files
- Prior year report to management
- Accounting systems notes
- Discussions with management
- Review of board minutes
- Current year budgets and management accounts
- Milky Way’s website
- Financial statements of competitors

5

10

3 (a) Up to 1 mark per explanation of why this could indicate going concern problems, if just identify indicator then maximum of ½ mark, overall maximum of 5 indicators.

- Reduction in sales from main customers
- Withdrawal of credit from some suppliers
- Potential legal action from supplier
- Low current ratio
- Negative monthly cash flows
- Loan of \$2.3 million due for repayment within one year
- Possible change in legislation, key product could become obsolete

5

(b) Up to 1 mark per well described procedure.

- Request extension of cash flow forecast to cover period to 30 September 2016
- Review cash flow forecasts
- Sensitivity analysis
- Discuss if sales levels have increased and if any new customers obtained
- Review post year-end sales and order book
- Discuss if alternative finance obtained to repay loan
- Review suppliers' correspondence
- Discuss contingency plans
- Enquire of lawyers any further litigation by suppliers
- Enquire of lawyers on possible change in legislation
- Subsequent events
- Board minutes
- Management accounts
- Written representation

5

10

4 Up to 1 mark per well described risk and up to 1 mark for each well explained response. Overall maximum of 5 marks for risks and 5 marks for responses.

- Depreciation rates and asset lives
- Adjustments for movements in inventory to the year-end date
- Write down of inventory
- Contingent asset
- Unreconciled differences on bank reconciliations
- Manipulation of profit due to directors' bonus
- Reporting timetable shortened

10

5 (a) Up to 1 mark each per well explained strength. If not well explained, then just give ½ mark for each, overall maximum of 5 marks for 5 points.

- Sequentially numbered clock cards
- Automatic calculations of gross, net pay and deductions
- Sample of calculations double checked
- Separate human resources and payroll department
- Bonus communicated in writing to payroll
- List of bank payments agreed in detail to payroll records

5

(b) Up to 1 mark each per well explained deficiency and recommendation. If not well explained, then just give ½ mark for each. Overall maximum of 6 marks each for deficiencies and recommendations.

- Clock in/out process unsupervised
- Employee breaks not monitored
- Temporary staff are not appointed by human resources department
- Overtime report reviewed after payment
- Authorisation of discretionary bonus
- No input checks over entry of bonus into payroll
- Payroll manager reviews the bank transfer listing prior to payment and can change payroll records
- No identity checks prior to cash wages pay out

12

(c) Up to 1 mark per well described procedure, overall maximum of 3 marks.

- Compare total payroll expense to the prior year and investigate any significant differences
- Review monthly payroll charges, compare to the prior year, budgets, discuss with management
- Compare overtime pay as a percentage of factory normal hours against prior year, investigate any significant differences
- Perform a proof in total of total wages and salaries, compare to actual, and investigate any significant differences

3

20

- 6 (a)** Up to 1 mark per well explained point, maximum of 4 points.
- Reliability increased when it is obtained from independent sources
 - Internally generated evidence more reliable when the controls are effective
 - Evidence obtained directly by the auditor is more reliable than evidence obtained indirectly or by inference
 - Evidence in documentary form is more reliable than evidence obtained orally
 - Evidence provided by original documents is more reliable than evidence provided by copies
- 4
- (b) (i)** Up to 1 mark per well described procedure, overall maximum of 8 marks.
- Before the count**
- Review the prior year audit files to identify significant inventory issues from last year
 - Discuss with management if any new warehouses or any sites have significant control issues
 - Decide which of the 12 warehouses the audit team members will attend
 - Review a copy of the proposed inventory count instructions
- During the count**
- Observe the counters to confirm if inventory count instructions are being followed
 - Perform test counts inventory to sheets and sheets to inventory
 - Confirm procedures for damaged goods are operating correctly
 - Observe procedures for movements of inventory during the count
 - Obtain a photocopy of the completed inventory sheets
 - Identify and make a note of the last goods received notes and goods despatched notes
 - Discuss with the internal audit supervisor how he has estimated the raw materials quantities
- 8
- (ii)** Up to 1 mark per well described procedure, overall maximum of 4 marks.
- Cast the schedule of intangible assets
 - Agree the opening balances to the prior year financial statements
 - Agree the closing balances to the general ledger, trial balance and draft financial statements
 - Recalculate amortisation charged in the year and confirm in line with the policy of straight line over five years
 - For new projects, discuss with management the stage of development and if capitalised or expensed
 - For those expensed as research, agree costs to invoices, supporting documentation and to inclusion in profit or loss
 - For those capitalised as development, agree costs to invoice and confirm technically feasible by discussion with development managers or review of feasibility reports
 - Review market research reports to confirm Andromeda has the ability to sell the product
 - Review the disclosures in the financial statements in accordance with IAS 38 *Intangible Assets*
- 4
- (c)** Up to 1 mark per valid point, overall maximum of 4 marks.
- Discussion of issue
 - Calculation of materiality
 - Type of audit report modification required
 - Impact on audit report
- 4